REDACTED

# REBUTTAL TESTIMONY

OF

JUDITH R. MARSHALL

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY
d/b/a AMERITECH ILLINOIS

DOCKET NOS. 98-0252/0335
CONSOLIDATED

JANUARY 11, 2001

**Q. Please state your name and business address.**

A. My name is Judith R. Marshall and my business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

**Q. By whom are you employed and in what capacity?**

A. I am employed by the Illinois Commerce Commission ("Commission") as an Economic Analyst in the Telecommunications Division.

**Q. Are you the same Judith R. Marshall that has previously offered pre-filed testimony in this docket?**

A. Yes, I am. My direct testimony in this case is presented in ICC Staff Exhibit 4, with its attachments

**Q. What is the purpose of your rebuttal testimony in this proceeding?**

A. My rebuttal testimony responds to the rebuttal testimony of Illinois Bell Telephone Company d/b/a Ameritech Illinois ("AI" or "the Company") witnesses Gebhardt, Dominak, O'Brien, and Palmer. My testimony presents an overall summary of Staff's position regarding rates in this docket. I am primarily responsible for issues

associated with merger related costs and savings and annual monitoring reports. I also sponsor adjustments related to the amortization of a 1994 accounting change.

**Overview of Rate Design**

**Q. Please discuss the treatment of shared and common costs in the preparation of long run service incremental cost studies ("LRSIC").**

A. My understanding of the Commission's LRSIC rule, 83 Illinois Administrative Code Part ("Part") 791, is that shared costs or costs caused by a group of services are properly included in the LRSIC of that group of services. Common costs or costs which would be incurred even if the service were not produced are properly excluded from LRSIC. Therefore, shared costs must be distinguished from common costs. Mr. Palmer is correct that the addition of such costs to LRSICs of noncompetitive services does not represent a price or revenue floor for pricing determinations. (AI Ex. 10.1, p. 4).

**Q. Does part 791 provide clear guidance on the treatment of spare capacity in the preparation of LRSIC studies?**

A. Yes. Part 791 requires that usable capacity, defined as the maximum physical capacity of the equipment or resource less any capacity required for maintenance,

testing or administrative purposes, be utilized in LRSIC studies. Since LRSICs have traditionally been used as a pricing floor goal in Illinois, no additional adjustment for spare capacity need be considered in establishing pricing floors for individual services.

**Q. Please comment on the presentations to Staff discussed at page 43 of Mr. Palmer's testimony.**

A. Company presentations to Staff are only a one way flow of information from the company representative to members of the Commission Staff who are able to attend the presentation; such presentations reflect only the views of the company. Staff is not provided with advance knowledge of the information being presented and has no opportunity to review the information, prepare meaningful questions or provide any sort of response. Staff's attendance at such a presentation should in no way be viewed as an acceptance of the material being presented. Only the Commission, through its Orders, can determine whether the company's changes to its LRSIC methodology produce acceptable results.

This consolidated docket is the first case where AI's revised LRSIC methodology is being tested in an evidentiary proceeding. In my opinion, Mr. Hanson is correct that AI should fully disclose and support the revisions it has made to its LRSIC methodology within this case.

**Q. Since the filing of Staff's direct testimony, has the Commission Staff taken steps to aid its understanding of AI's revised LRSIC methodology?**

A. Yes. The Commission retained the services of a third party consultant, Mr. Larry Fowler, to review the Loop Facilities Analysis Model ("LFAM") under Staff supervision and direction. Both Staff witness Hanson and I worked closely with Mr. Fowler in this capacity. I provided him with a list of questions regarding the workings of the model, consulted with him on a daily basis, accompanied him to Ameritech offices to test the LFAM model on two occasions, and participated in teleconferences with SBC personnel.

**Q. Do you agree with Mr. Palmer that the current version of the LFAM model produces reasonable results? (AI Ex. 10.1, p. 48).**

A. No, I do not agree that the LFAM model produces reasonable results. Based on the additional information provided in Mr. Palmer's rebuttal testimony, Mr. Fowler's review of LFAM, and my own knowledge of LRSIC methodology, it is my opinion that the current version of the LFAM model does not comply with Part 791 and should not be utilized in this case. If the Commission determines that the LFAM model may be used, several changes to input assumptions should be required.

**Q. Why do you believe that the current version of LFAM is not in compliance with Part 791 requirements?**

A. Section 791.20 defines forward looking costs as the costs to be incurred by a carrier in the provision of a service. These costs shall be calculated as if the service were being provided for the first time and shall reflect *planned adjustments* in the firms plant and equipment. These forward looking costs are based on the least cost technology currently available whose cost can be reasonably estimated based on available data. Section 791.40(1) provides that a LRSIC study shall be based upon the locations of, and planned locational changes to, the existing network configuration. As noted in Mr. Palmer's direct testimony (AI Ex. 10.0, page 8), the LFAM model re-designs AI's entire distribution system incorporating a purely hypothetical, futuristic system. Ameritech provides no evidence that this hypothetical system reflects only planned adjustments to plant and equipment or is based on the existing network configuration as required by the rule.

Section 791.40 provides that a LRSIC study shall reflect the demand for the entire service that is affected by the business or regulatory decision at hand. If the LRSIC study is for a new service, the study shall include all demand forecasts used in the computations. Staff interprets this section of the rule to require that the demand utilized to calculate the capacity included in the LRSIC study must also be used to allocate the costs of that capacity. AI has modified its LRSIC methodology (AI Ex.

10.1, pages 43-44) so that it is no longer in compliance with Staff's interpretation of this rule.

Finally, Section 791.20 provides the definition of usable capacity discussed above. Mr. Palmer concedes that the effective fill for drop and fiber feeder cable is significantly less than the 85% fill factor calculated in compliance with Part 791.

**Q. In addition to the non-compliance with Part 791, are there other reasons why the current version of LFAM does not produce reliable results?**

A. Yes, there are. Staff witness Mark Hanson addresses other weaknesses in the current version of LFAM.

**Q. Is Mr. Gebhardt correct in his assumption that the Commission did not initiate the GTE rate reductions referred to in his testimony (AI Ex. 1.3, Page 8)?**

A. Not entirely. Each of these rate reductions was initiated by a Commission Staff investigation of whether GTE was over-earning based on financial monitoring reports. GTE voluntarily reduced rates in response to Staff's investigations. In my opinion, it is likely that one or more similar Staff investigations of AI earnings would have occurred absent the Alt. Reg. Plan.

**Q. Please respond to Mr. Gebhardt's rebuttal testimony regarding the allocation of AI's revenue requirement between competitive and non-competitive services. (AI Ex. 1.3, page 22).**

A. Mr. Gebhardt is mistaken when he states that no one in this proceeding has debated or refuted the analysis presented in his supplemental direct testimony. My direct testimony, ICC Staff Exhibit 4.00, pages 4 through 7, addresses this issue. In summary, Mr. Gebhardt's allocation is not appropriate. (In addition, Mr. Gebhardt proposed a similar allocation in the CUB Complaint case, Docket No. 96-0178. In that case I testified on behalf of Staff [Ex. 4.00] that such an allocation should not be made in a rate setting proceeding.)

To estimate separate rates of return for competitive and non-competitive services Mr. Gebhardt allocates common costs to competitive and non-competitive services, which cannot be done in any meaningful way since common costs by definition cannot be satisfactorily attributed to any specific service. To the best of my knowledge, such an approach has never been considered or adopted by the Commission in any rate making proceeding. Mr. Gebhardt's calculation of separate rates of return for competitive and non-competitive services should be given no weight by the Commission. In the event that the Commission determines that rates

should be re-initialized in this proceeding, it should base rates on AI's total jurisdictional revenue requirement.

**Merger Related Costs and Savings**

**Q. AI witness O'Brien addresses your testimony regarding the flow through of net merger savings (AI Ex. 3.1, pages 18-19). Has your position related to the treatment of merger costs and savings changed since you filed direct testimony in this case?**

A. No, my position regarding this issue is unchanged. However, my position is based upon the Commission's Order in Docket 98-0555 and Staff's recommendation that any alternative regulatory plan approved in this proceeding be reviewed in five years. If the Commission does not order such a review of the plan, a decision is needed on the future treatment of merger costs and savings.

**Q. Is Mr. O'Brien correct that the amount of net merger savings should be based upon the year 2002 results?**

A. No. Current SBC projections indicate that the going level merger related costs and savings will not be reached until 2004. Approximately 96% of the going level will have been reached at the end of 2002, if implementation of best practices identified

by SBC's merger integration teams is achieved on schedule. (Barrington Wellesley Group, Inc. ("BWG") Final Report, page VIII-27) Significant savings are projected in the areas of procurement and benefits and these savings are less likely to be fully reflected in 2002 actual amounts because of delays in implementation of planned best practices. One of BWG's recommendations is that the Commission consider extending the three-year period for sharing of net merger savings to ensure an equitable apportionment to the Company and its ratepayers. (BWG Final Report, page VIII-44).

**Q. Do you agree with Mr. O'Brien that merger related costs and savings could be passed along to customers outside of the annual filing?**

A. Yes. It is appropriate that merger related costs and savings should be passed to customers as soon as they have been identified by the Commission. This treatment would parallel the company's proposed treatment of exogenous factors.

**Q. What alternative do you recommend, in the event that the Commission does not order a future review of the alternative regulation plan in this docket?**

A. The Commission should continue its annual audits of merger related costs and savings until SBC/Ameritech achieves a going level of net savings. Based on current SBC projections, it is my opinion that this going level of savings will not be

reached before 2004. Audited information for 2004 will be available in 2005. The audited 2004 data could also be compared to actual 2005 data for reasonableness. Effective with the price cap filing of April 1, 2006, the Commission could make a one-time adjustment to the price cap index to reflect the going level of merger costs and savings and discontinue the annual audit requirement. The final year of audited merger costs and savings would be 2004, which is equivalent to the time frame associated with continuing this requirement until a five year review of the alternative regulatory plan.

**Q. Is there another alternative that the Commission could consider for the treatment of merger costs and savings?**

A. Yes. The Commission could consider modifying its requirement that actual merger costs and savings be audited annually. If such a modification were adopted, the Commission could adjust the alternative regulatory formula at this time to reflect 50% of SBC's current estimate of merger costs and savings at the going level. It is my understanding that merger costs and savings amounts have already been reviewed by upper management levels and thoroughly analyzed by SBC's merger integration teams. Therefore, the current estimate of net merger related costs and savings of (**Redacted**), (Barrington Wellesley Group, Inc. SBC/Ameritech Merger Investigation Confidential Final Report, p. VIII-24) has a high probability of being achieved. As noted at page VIII-21 of BWG's final report, "The transition Policy

Group ("TPG") made clear to the teams that targets were firm and not negotiable. The only exception was that benchmarking errors could be corrected, but only if it made a difference."

Adoption of a merger costs and savings factor at this time would reduce the regulatory burden of determining the actual amount of costs and savings on an annual basis. It would conserve both Commission and Company resources expended in the annual audits and would simplify the annual price cap filing proceedings. Condition 26 of the existing merger order (Docket 98-0555 Order), which requires annual audits of actual merger costs and savings, will expire if the Commission chooses a different approach to merger costs and savings in this docket.

**Q. If the Commission chooses to make a one-time adjustment to reflect the going level merger related costs and savings, how should that adjustment be quantified?**

A. Ameritech can provide an allocation of the revised amount of planned net merger costs and savings to Illinois Intrastate operations. Such an allocation was provided by Ameritech in the merger case, Docket 98-0555. Since the planned net merger savings have increased by approximately (**Redacted**) %, Staff anticipates a comparable increase in the going level amount previously calculated to be $90

million. The Commission has ordered that 50% of net merger savings be shared with ratepayers.

**Annual Reports Under Alternative Regulation**

**Q. Has your position regarding annual reporting requirements changed since the filing of your direct testimony?**

A. No, it has not. The financial and other reporting requirements included in my direct case were ordered by the Commission in Docket 92-0448 and should be continued. Mr. O'Brien considers financial reporting requirements to be unnecessary and burdensome to the Company. (AI Ex. 3.1, p. 20-21). Staff's financial reporting requirement is reasonable and appropriate. I do not consider it to be unduly burdensome on AI.

**Q. Should Ameritech Advanced Data Services ("AADS") investment be included in the $3 billion Infrastructure Maintenance Investment requirement (AI Ex. 3.1, p. 19-20)?**

A. As discussed in my direct testimony, I believe the Commission's Order clearly specified that the investment commitment applies to Ameritech Illinois. Therefore, I

believe that expenditures of other Ameritech affiliates should not be considered to satisfy this agreed upon commitment.

**Q. Should the reporting of AADS investment have any impact on the provision of advanced services such as DSL for Ameritech Illinois?**

A. Absolutely not. I find Mr. O'Brien's premise that Ameritech Illinois would be willing to exclude AADS investment from reporting, with the understanding that it would be unreasonable for the Commission to expect innovation in advanced services such as DSL for Ameritech Illinois customers absurd (AI Ex. 3.1, p. 20). SBC has committed to the provision of advanced services such as DSL to Ameritech Illinois customers during its merger proceeding. These commitments must be honored regardless of how infrastructure investment is reported.

**Amortization of FAS 71 Adjustment**

**Q. Has your position regarding the FAS 71 adjustment changed since the filing of your direct testimony?**

A. No, my position regarding this adjustment is unchanged. Mr. Dominak's rebuttal testimony clarifies that this entire adjustment is related to the depreciation reserve deficiency. The Commission found in Docket 92-0448 that no amortization of a

depreciation reserve deficiency was appropriate for inclusion in an alternative regulatory plan. The Commission also determined that AI's analog switching account should be amortized over a five year period which has since expired. AI's recasting of this depreciation issue as a FAS 71 adjustment is nothing more than a second attempt to recover costs previously disallowed for rate making purposes.

**Q. Is the 8 year amortization period recommended by AI reasonable?**

A. In my opinion it is not. At the time that AI first sought recovery of this depreciation reserve deficiency in Docket 92-0448, a five year amortization period was proposed by AI. As noted above, a five year amortization period was adopted by the Commission in that docket for analog switching equipment. In my opinion, AI's adoption of an 8 year amortization period is simply an artificial device to assure consideration of this issue in the planned five year review of the alternative regulatory plan. If the Commission believes that a five year amortization period is appropriate for recovery of a depreciation reserve deficiency, it should adopt my FAS 71 adjustment because the five year period for recovery has passed.

**Q. At pages 101-104 of his rebuttal testimony, Mr. Gebhardt discusses my alternative proposal to treat the write-down of assets as a one-time event. Was this write-down a one-time event?**

A. Absolutely. This event occurred in 1994 and was fully reported for financial purposes. No further discussion of reaction by the financial community is relevant. Any capital recovery shortfall experienced by the Company as a result of this write-off has been fully recovered in the high earnings experienced during the five years of the Alt. Reg. Plan. Mr. Gebhardt's hypothetical approach, which would add back the write-down as if it had never occurred and then begin a new three year amortization of the write-down, is not representative of the actual event and should be given no weight by the Commission.

**Conclusion**

**Q. Does this conclude your rebuttal testimony?**

A. Yes, it does.